Yandraduth Googoolye: Implementation of Basel II in Mauritius

Address by Mr Yandraduth Googoolye, First Deputy Governor of the Bank of Mauritius, at the Special Banking Committee on the implementation of Basel II in Mauritius, Port Louis, 21 September 2007.

*   *   *

Chairman
Chairman of the Mauritius Bankers Association
Chief Executive of the Mauritius Bankers Association
Chief Executives of banks
Representatives of banks
Dear colleagues

It gives me great pleasure to address you on the implementation of Basel II. As we all know, Basel II is a major challenge for small economies like ours. However, we must take pride in the fact that all our banks, regardless of their size, are committed to the implementation of Basel II.

Right at the outset, the Bank of Mauritius has favoured a consultative approach to the implementation of Basel II. Since the setting up of the Main Committee, I must say that considerable work has been achieved. We take pride in the fact that we are having recourse to our in-house expertise and as we move forward we are creating synergies for nurturing our local jurisdiction.

As you are well aware, the implementation of Basel II is a daunting and challenging task for all regulators the world over. It is also the case for Mauritius. Much progress has been made by our in-house staff and the representatives of banks, at the level of the working groups. Despite uncertainties at some stage, we are confident that the project has regained momentum and that we will reach the March 2008 target for the parallel run. The Bank has set up a new Basel II Unit, the members of which are present here today.

May I seize the opportunity to extend our appreciation to the dedicated representatives of banks that have relentlessly put in efforts to reach where we are today. We look forward to their ongoing collaboration.

Basel II framework

Today, I would like to briefly touch upon the evolution of the revised framework, its broad structure and the preparatory measures taken by the Bank for implementing this framework, and the challenges facing the industry in its migrating to Basel II. We must bear in mind that the Basel II framework allows for flexibility and we, at the Bank of Mauritius, will exercise our discretion to adapt the new framework to the specificities of our jurisdiction. The need to achieve greater financial inclusion and to provide an efficient credit delivery mechanism remains our overriding consideration.

The Basel I Accord dates back to 1988 when the Basel Committee on Banking Supervision released a framework for capital adequacy. Mauritius adopted the framework in 1993 at a time where it was felt that the local jurisdiction should align itself to international standards of banking supervision. Our banks have since then maintained capital adequacy ratios higher than the 10 per cent minimum required.

Over the years, the international banking sector has evolved, so has our local banking industry. It was observed at the presentations made by banks on their progress towards the implementation of Basel II that advances have been made in risk management, information systems, and banks' internal processes. Our banking industry is on track.

With its three pillars, Basel II provides a rigorous framework that ties the amount of capital that banks require to maintain with their specific risks, thus establishing an enterprise-wide risk management framework.

Pillar I provides a range of approaches to calculate the capital charges for credit, market and operational risk. Pillar 2 requires banks to develop an Internal Capital Adequacy Assessment Process (ICAAP) that set capital targets that are commensurate with the banks’ risk profile and control environment.

Pillar 3, Market Discipline, complements the minimum capital requirement and the supervisory review process. It aims at encouraging banks to disclose to market participants essential information. In other words banks are also monitored by the markets.

State of readiness of our banks

The presentations organized by the Bank of Mauritius turned out to be very fruitful exercise. I wish to thank the banks for their participation in this exercise. I have to mention here my regrets for not being able to attend the presentations made by the banks during the last two weeks.

Nonetheless I have been duly briefed by my staff of the Basel Unit who were present, on progress made by individual banks with respect to the implementation of Basel II.

A number of issues were raised that would need to be taken up at the level of the Main Committee and Working Groups. Some of them would be addressed today in the presentation to be made by the Basel Unit in the course of this Special Banking Committee meeting.

It came out during the presentations that banks are striving to build up their capabilities to move to the new framework. We noted the contrast in approach between the international banks and the local banks. The former are getting full support from their head office while some local banks are having recourse to the service of consultants to upgrade their systems. Overall most banks, with the exception of one or two banks, will be able to meet the March 2008 target for the parallel run. It was also felt that individual banks had a number of issues specific to their banks that they would wish to discuss. It was reported to us during the presentations that banks were more willing to share their individual views with us, which enabled us to have a better understanding of real issues. We should pull our efforts together to get all banks on board. Accordingly, the Bank of Mauritius invites banks to solicit individual meetings during which those issues could be discussed.

Challenges ahead

Following the issue of the Guideline on Operational Risk Management and Capital Adequacy Determination, banks have made significant progress in the setting of an operational risk management framework. Some of them have been ambitious enough to set the stage for the transition to the more advanced approaches. The setting up of an operational risk database would be an important tool in this transition. However, there exists a number of issues that need to be addressed. I have in mind the GOLD database of the British Bankers Association which is operated by the banks in the UK. We could draw our inspiration from this concept in the building of our own operational loss database. We urge the Mauritius Bankers Association to examine this issue.

Our concern as regulators is to have a stable financial system with well-capitalised banks that are stable and able to withstand periods of financial distress. The recent subprime loan crisis reminds us of the necessity to build up a financial system that is resilient to shocks. Risk-taking is the essence of banking. However, banks should manage their risks so as to preserve depositors’ interests. This crisis has triggered issues like the necessity to regulate rating agencies. The Basel Committee would have to review its approach towards the reliance on the external ratings of credit agencies. The focus would then be on the advanced approaches of the Basel II framework where banks would have o rely on their own internal models for the calculation of their capital requirements. In this context, the setting up of a centralized database for credit risk is more than ever on our agenda. However, a number of overarching issues need to be addressed at the level of the CEOs, which will be enumerated during the presentation to be made shortly.

To conclude, I wish to comment on an issue, which is of interest to all of you. The Bank is sensitive to the representations made by banks to reduce the capital adequacy ratio. During the course of the supervisory review process, the Bank shall assess the capital adequacy ratio of banks taking due consideration to the risks and the capital requirements of banks. Any trade off in capital would have to be matched by better risk management systems. A policy decision for a reduction would have to be taken in consultation with the banking industry in the light of the ICAAP assessment.

The new framework provides an incentive for better risk management. Banks should seize this opportunity.

I now leave the floor to the Mr Chinniah, Assistant Director Supervision for a presentation.